The Insurance Company of Prince Edward Island 2003

ANNUAL REPORT

The Insurance Company
Of Prince Edward Island
People you know you can trust

Responsibility for Financial Statements

The financial statements are the responsibility of management and have been prepared in conformity with accounting principles generally accepted in Canada. In the opinion of management, the financial statements fairly reflect the financial position, results of operations and cash flows of the Insurance Company of Prince Edward Island (the Corporation) within reasonable limits of materiality.

Preparation of financial information is an integral part of management's broader responsibilities for the ongoing operations of the Corporation. Management maintains an extensive system of internal accounting controls to ensure that transactions are accurately recorded on a timely basis, are properly approved and result in reliable financial statements.

An actuary has been appointed by the Corporation to carry out a valuation of the policy liabilities and to issue a report thereon to the shareholders and regulatory authorities. The valuation is carried out in accordance with accepted actuarial practice and common Canadian insurance regulatory requirements. The policy liabilities consist of a provision for unpaid claim and adjustment expenses on the earned portion of policies and of future obligations on the unearned portion of policies. In performing this valuation, the actuary makes assumptions as to future rates of claim frequency and severity, inflation, reinsurance recoveries, expenses and other contingencies, taking into consideration the circumstances of the Corporation and the nature of the insurance policies. The actuary also makes use of management information provided by the Corporation and the work of the external auditors in verifying the data used in the valuation.

The financial statements have been examined and approved by the Board of Directors. An Audit and Finance Committee, composed of members of the Board of Directors, meets periodically with financial officers of the Corporation and the external auditors. These external auditors have free access to this Committee, without management present, to discuss the results of their audit work and their opinion on the adequacy of internal financial controls and the quality of financial reporting.

KPMG have been appointed external auditors. Their responsibility is to report to the shareholders and regulatory authorities regarding the fairness of presentation of the Corporation's financial position and results of operations as shown in the financial statements. In carrying out their audit, the external auditors also make use of the work of the actuary and his report on the policy liabilities. The Auditors' Report outlines the scope of their examination and their opinion.

Charlie Cooke
President

John Dobie
Chief Financial Officer

February 13, 2004

Actuary's Report

To the Shareholders of the Insurance Company of Prince Edward Island

I have valued the policy liabilities of the Insurance Company of Prince Edward Island for its statement of financial position at December 31, 2003 and their change in the statement of operations and retained earnings for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion the amount of policy liabilities makes appropriate provision for all policyholder obligations, and the financial statements fairly present the results of the valuation.

Richard Gauthier
Fellow, Canadian Institute of Actuaries

February 13, 2004

Auditors' Report

To the Shareholders of the Insurance Company of Prince Edward Island

We have audited the statement of financial position of the Insurance Company of Prince Edward Island as at December 31, 2003 and the statements of operations and retained earnings (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2003 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Regina, Canada

February 13, 2004

Statement of Financial Position

December 31	2003	2002
	(thousands of $)	
Assets		
Cash and treasury bills (note 3)	$ 3,262	$ 2,135
Accounts receivable (notes 4 & 14)	4,770	3,860
Deferred policy acquisition costs	1,022	847
Unpaid claims recoverable from reinsurers (notes 6 & 7)	965	902
Reinsurers' share of unearned premiums (note 6)	120	110
Future income taxes (note 9)	218	459
Investments (note 5)	11,427	10,105
Property, plant and equipment	1	6
	$ 21,785	$ 18,424
Liabilities		
Accounts payable	$ 292	$ 105
Premium taxes payable	54	97
Future income taxes (note 9)	103	64
Amounts due to reinsurers (note 6)	31	31
Provision for unpaid claims (notes 7 & 14)	10,824	8,936
Unearned reinsurance commissions	35	33
Unearned premiums (note 14)	5,411	4,785
	16,750	14,051
Shareholders' equity		
Share capital (note 10)	4,800	4,800
Retained earnings (deficit)	235	(427)
	5,035	4,373
	$ 21,785	$ 18,424

(see accompanying notes)

Statement of Operations and Retained Earnings (Deficit)

year ended December 31	2003	2002
	(thousands of $)	
Gross premiums written	$ 9,848	$ 8,862
Net premiums written	$ 9,284	$ 8,457
Premiums earned (note 6)	**$ 8,873**	$ 7,204
Claims incurred (note 6)	6,193	5,256
Commissions (note 6)	1,250	961
Premium taxes (note 6)	344	273
Administrative expenses	838	722
Facility Association participation (note 14)	(207)	149
Total claims and expenses	**8,418**	7,361
Underwriting profit (loss)	**455**	(157)
Investment earnings (note 8)	664	403
Income before taxes	**1,119**	246
Current income tax expense (note 9)	143	–
Future income tax expense (note 9)	280	102
Capital taxes	12	–
Net income	**684**	144
Retained earnings (deficit), beginning of year	(427)	(571)
Dividends paid (note 10)	(22)	–
Retained earnings (deficit), end of year	**$ 235**	$ (427)

(see accompanying notes)

Statement of Cash Flows

year ended December 31	2003	2002
	(thousands of $)	
Cash provided by (used for):		
Operating activities		
Net income	$ 684	$ 144
Non-cash items:		
Amortization	86	76
Realized gain on disposal of investments	(124)	(3)
Investment write downs	35	24
Change in non-cash operating items (note 12)	1,782	1,666
	2,463	1,907
Investing activities		
Purchases of investments	(15,425)	(8,118)
Proceeds on sale of investments	14,023	4,352
	(1,402)	(3,766)
Financing activities		
Dividends paid	(22)	–
Preferred share issuance	–	1,000
	(22)	1,000
Increase (decrease) in cash and cash equivalents	**1,039**	(859)
Cash and cash equivalents:		
Balance, beginning of year	1,404	2,263
Balance, end of year	**2,443**	1,404
Plus treasury bills greater than 91 days to maturity from acquisition date	**819**	731
Cash and treasury bills per statement of financial position	**$ 3,262**	$ 2,135

(see accompanying notes)

Notes to the Financial Statements

December 31, 2003

1. STATUS OF THE CORPORATION

The Insurance Company of Prince Edward Island (the Corporation) was incorporated under the laws of Prince Edward Island. The Corporation is licensed to conduct business in Prince Edward Island and New Brunswick and holds provincial insurers' licences under the *Prince Edward Island Insurance Act* and the *New Brunswick Insurance Act.*

2. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Corporation are in accordance with Canadian generally accepted accounting principles. The following are considered to be significant:

Deferred policy acquisition costs

Premium taxes, commissions and certain underwriting and policy issuance costs are charged to expense over the terms of the insurance policies to which such costs relate. The method followed in determining the deferred policy acquisition costs limits the amount of the deferral to the amount recoverable from unearned premiums after giving consideration to investment income, as well as claim and adjustment expenses expected to be incurred as the premiums are earned.

Investments

Bonds are recorded at amortized cost. Treasury bills, common shares and preferred shares are recorded at cost. Dividends on common shares and preferred shares are recognized as income on their record dates. Gains and losses on the sale of investments are recognized on the date of trade. Investments are written down when there is a decline in value that is other than temporary.

Property, plant and equipment

Property, plant and equipment consist of computer hardware, software and other equipment and are recorded at cost, less accumulated amortization. Amortization is recorded on a straight-line basis, commencing in the year in which the assets are placed in service, over their estimated useful lives of three years for computer hardware and software and five years for other equipment.

Provision for unpaid claims

The provision for unpaid claims represents an estimate of the total cost of outstanding claims to the year-end date. Included in the estimate are reported claims, claims incurred but not reported and an estimate of adjustment expenses to be incurred on these claims. The provision is calculated without discounting. The estimates are necessarily subject to uncertainty and are selected from a range of possible outcomes. During the life of the claim, adjustments to the estimates are made as additional information becomes available. The change in outstanding losses plus paid losses is reported as claims incurred in the current period.

Premiums

Premiums written are taken into income over the terms of the related policies. Unearned premiums represent the portion of the policy premiums relating to the unexpired term of each policy.

Reinsurance ceded

Reinsurance premiums ceded and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts. Unpaid claims recoverable from reinsurers, reinsurers' share of unearned premiums and unearned reinsurance commissions are estimated in a manner consistent with the method used for determining the provision for unpaid claims, unearned premiums and deferred policy acquisition costs respectively.

Income taxes

The Corporation uses the asset and liability method of accounting for income taxes. Current income taxes are recognized as estimated income taxes payable for the current year. Future income tax assets and liabilities consist of temporary differences between tax and accounting bases of assets and liabilities as well as the benefit of losses available to be carried forward to future years for tax purposes that are likely to be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized as income in the period that includes the date of enactment or substantive enactment. A valuation allowance is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

Cash and cash equivalents

Cash and cash equivalents in the cash flow statement consist of cash on hand and treasury bills with a maturity of 91 days or less from the date of acquisition.

3. CASH AND TREASURY BILLS

Cash and treasury bills include treasury bills and commercial paper that have an average effective interest rate of 2.8% (2002 – 2.8%) and an average remaining term to maturity of 20 days (2002 – 74 days). The Corporation's investment policy states that securities investments must meet minimum investment standards of R-1 mid, as rated by a recognized credit rating agency.

4. ACCOUNTS RECEIVABLE

Accounts receivable is comprised of the following:

	2003	2002
	(thousands of $)	
Facility Association receivable	$ 2,164	$ 1,091
Due from insureds	1,828	1,634
Due from broker	644	624
Accrued investment income	113	104
Other	13	15
Income taxes	7	9
Due from reinsurers	1	383
Total accounts receivable	$ 4,770	$ 3,860

5. INVESTMENTS

The carrying value and fair value of the Corporation's investments are as follows:

	2003		2002	
	(thousands of $)			
	Carrying Value	Fair Value	Carrying Value	Fair Value
Bonds and debentures	$ 10,915	$ 11,149	$ 9,293	$ 9,563
Preferred shares	343	344	608	629
Common shares	169	196	204	212
Total investments	$ 11,427	$ 11,689	$ 10,105	$ 10,404

Details of significant terms and conditions, exposures to interest rate and credit risks of investments are as follows:

(i) Bonds and debentures:

The Corporation's investment policy limits its investment concentration in any one investee or related group of investees to 5% of the market value of investment assets for corporate bonds and debentures. Also, a minimum of BBB is placed on the investment grade of bonds and debentures that may be purchased.

The carrying value and average effective interest rates are shown in the following chart by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties. The carrying values are essentially the same as the principal values and therefore the average effective rates are not materially different from the coupon rates. Interest is generally payable on a semi-annual basis.

	2003		2002	
	(thousands of $)			
Term to maturity (years)	Carrying Value	Average Effective Rates	Carrying Value	Average Effective Rates
Government of Canada:				
After one through five	$ 4,601	4.6%	$ 3,334	4.6%
After five	1,073	5.1%	1,692	5.6%
Canadian provincial and municipal:				
After one through five	1,488	5.4%	1,496	6.8%
After five	1,137	5.6%	736	5.8%
Canadian corporate:				
After one through five	1,964	5.1%	1,603	5.9%
After five	652	5.9%	432	6.0%
Total bonds and debentures	$10,915		$ 9,293	

(ii) Preferred shares:

Preferred shares have no fixed maturity dates, are generally not exposed to interest rate risk and the majority of shares held are retractable. Dividends are generally declared on an annual basis. The average effective rate is 4.6% (2002 – 5.3%).

The Corporation's investment policy limits its investment in preferred shares to issues rated Pfd-2 or higher.

(iii) Common shares:

Common shares have no fixed maturity dates and are generally not exposed to interest rate risk. Dividends are generally declared on an annual basis. The average effective rate is 3.8% (2002 – 3.8%).

The Corporation's investment policy requires Board of Director approval for its investment in common stocks and equivalent instruments of Canadian and non-Canadian companies.

6. UNDERWRITING POLICY AND REINSURANCE CEDED

The Corporation underwrites and reinsures contracts of insurance with SCISL and other reinsurers, which limits the liability of the Corporation to a maximum amount of $150,000 on any one loss, and $250,000 on any one catastrophe.

The following table sets out the amount by which reinsurance ceded has reduced the premiums earned, claims incurred and commissions:

	2003	2002
	(thousands of $)	
Premiums earned	$ 555	$ 385
Claims incurred	520	692
Commissions and premium taxes	63	48

7. PROVISION FOR UNPAID CLAIMS

(i) Nature and variability of unpaid claims:

The establishment of the provision for unpaid claims is based on known facts and interpretation of circumstances and is therefore a complex process influenced by a large variety of factors. Measurement of the provision is uncertain due to claims that are not reported to the Corporation at the year-end date and therefore estimates are made as to the value of these claims. As well, uncertainty exists for reported claims that have not been settled, as all the necessary information may not be available at the statement of financial position date.

Factors used to estimate the provision include: the Corporation's experience with similar cases, historical trends involving claim payments, the characteristics of the class of business, claim severity and claim frequency such as those caused by natural disasters, the effect of inflation on future claims, court decisions and economic conditions. Time is also a critical factor in determining the provision, since the longer it takes to settle and pay a claim the more variable the ultimate settlement amount will be. Accordingly, short-tail claims such as property claims tend to be more reasonably predictable than long-tail claims such as liability claims.

As a result, the establishment of the provision for unpaid claims relies on a number of factors and on the judgment and opinions of a large number of individuals, which necessarily involves risk that the actual results may differ materially from the estimates.

Changes in the estimate for the provision for unpaid claims are as follows:

	2003	2002
	(thousands of $)	
Net unpaid claims – beginning of year	$ 8,034	$ 6,582
Payments made during the year relating to prior year claims	(2,009)	(1,930)
Deficiency (excess) relating to prior year estimated unpaid claims	55	(59)
Net unpaid claims for claims of prior years	6,080	4,593
Provision for claims occurring in the current year	3,779	3,441
Net unpaid claims – end of year	$ 9,859	$ 8,034

(ii) Type of unpaid claims:

	2003			2002		
	(thousands of $)					
	Gross	Reinsurance Recoverable	Net	Gross	Reinsurance Recoverable	Net
Auto	$ 9,203	$ 573	$ 8,630	$ 7,794	$ 773	$ 7,021
Property	244	12	232	294	4	290
Liability	1,377	380	997	848	125	723
Total	$10,824	$ 965	$ 9,859	$ 8,936	$ 902	$ 8,034

8. INVESTMENT EARNINGS

The components of investment earnings are as follows:

	2003	2002
	(thousands of $)	
Interest and dividends	$ 552	$ 414
Realized gain on sale of investments	124	3
Investment write down	(35)	(24)
Income from financing	23	10
Total investment earnings	$ 664	$ 403

Investment write downs relate to Canadian common shares.

9. INCOME TAXES

The Corporation's provision for income taxes is as follows:

	2003	2002
	(thousands of $)	
Current	$ 143	$ –
Future	280	102
Total income tax expense	$ 423	$ 102

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory income tax rates to income before income taxes. The reasons for the differences are as follows:

	2003	2002
	(thousands of $)	
Net income (loss) before income taxes	$ 1,119	$ 246
Combined federal and provincial tax rate	40.12%	42.12%
Computed tax expense based on combined rate	$ 449	$ 104
Increase (decrease) resulting from:		
Non-taxable portion of investment income	(26)	(18)
Other	–	16
Total income tax expense	$ 423	$ 102

The components of future income tax balances are as follows:

	2003	2002
	(thousands of $)	
Tax loss carryforward	$ –	$ 275
Provision for unpaid claims	206	184
Other	12	–
	218	459
less: valuation allowance	–	–
Future income tax assets	218	459
Bonds and debentures	85	44
Unpaid claims recoverable from reinsurers	18	18
Other	–	2
Future income tax liabilities	103	64
Net future income taxes	$ 115	$ 395

10. SHARE CAPITAL

Authorized:

- 30,000,000 common shares, with no par value.

- 6,000 class A, series 1 preferred shares with a par value of $100 per share, cumulative dividend paid as determined by the Board of Directors at a rate equal to the five-year Government of Canada bond rate plus 1% per annum adjusted pro rata if redemption takes place prior to the annual anniversary date of issuance. The company may redeem the shares in whole or part at any time for $100 per share.

- 10,000 class A, series 2 preferred shares with a par value of $100 per share, cumulative dividend paid as determined by the Board of Directors at a rate equal to the five-year Government of Canada bond rate plus 1% per annum adjusted pro rata if redemption takes place prior to the annual anniversary date of issuance. The company may redeem the shares in whole or part at any time for $100 per share.

- 2,484,000 class A, series 3 preferred shares with a par value of $100 per share, no set dividend rate, retraction or redemption rights.

- 5,000 class B, series 2 preferred shares with a par value of $100 per share, no set dividend rate, retraction or redemption rights.

- 2,495,000 class B, preferred shares with a par value of $100 per share, no set dividend rate, retraction or redemption rights.

	2003	2002
	(thousands of $)	
Issued and fully paid:		
3,000,000 common shares	$ 3,000	$ 3,000
4,000 Class A preferred shares, series 1	400	400
10,000 Class A preferred shares, series 2	1,000	1,000
4,000 Class B preferred shares, series 2	400	400
Total share capital	$ 4,800	$ 4,800
Shares issued during the year:		
Number of shares		
Class A preferred shares, series 2	-	10,000
Value of shares (000's)		
Class A preferred shares, series 2	-	$ 1,000

The class A preferred shares, series 1 and series 2, have cumulative dividends in arrears at Dec. 31, 2003 of $70,385 (2002 - $22,400) and $22,400 was paid in dividends during the year.

11. FAIR VALUE

The following method and assumptions were used to estimate the fair value of each class of financial instrument:

(i) For the following financial instruments the carrying amounts approximate fair value due to the immediate or short-term nature of these financial instruments:

(a) cash and treasury bills
(b) accounts receivable
(c) accounts payable
(d) premium taxes payable
(e) amounts due to reinsurers

(ii) For the following financial instruments the fair values are considered to approximate quoted market values on recognized stock exchanges, based on the latest bid prices.

(a) bonds and debentures
(b) preferred shares
(c) common shares

(iii) Provision for unpaid claims and unpaid claims recoverable from reinsurers.

The fair value of the provision for unpaid claims and unpaid claims recoverable from reinsurers has been omitted because it is not practicable to determine fair value with sufficient reliability (note 7).

12. CASH FLOWS

The change in non-cash operating items is comprised of the following:

	2003	2002
	(thousands of $)	
Change in non-cash operating items:		
Accounts receivable	$ (910)	$ (954)
Deferred policy acquisition costs	(175)	(234)
Unpaid claims recoverable from reinsurers	(63)	109
Reinsurers' share of unearned premiums	(10)	(26)
Future income taxes	280	109
Accounts payable	187	-
Premium taxes payable	(43)	60
Amounts due to reinsurers	-	(201)
Provision for unpaid claims	1,888	1,343
Unearned reinsurance commissions	2	7
Unearned premiums	626	1,453
	$ 1,782	$ 1,666

13. RELATED PARTY TRANSACTIONS

Included in these financial statements are transactions with various Saskatchewan Crown corporations, departments, agencies, boards and commissions related to the Corporation by virtue of common control by the Government of Saskatchewan and non-Crown corporations and enterprises subject to joint control and significant influence by the Government of Saskatchewan (collectively referred to as "related parties"). Transactions and amounts outstanding at year-end are as follows:

Category	2003	2002
	(thousands of $)	
Investments	$ 540	$ 331
Accounts receivable	2	1
Investment earnings	24	6

The Corporation has direct premiums that are written with Charlie Cooke Insurance Agency Ltd., claims adjusting fees from Atlantic Adjusting & Appraisals Ltd. and has premiums financed for policyholders by Maritime Finance & Acceptance Corporation. These companies are affiliated with the minority shareholder, who is a member of the Corporation's senior management. The policies written and the claim adjusting expenses paid are in the normal course of business. Transactions and amounts outstanding at year end are as follows:

Category	**2003**	2002
	(thousands of $)	
Accounts receivable	$ 644	$ 624
Accounts payable	60	54
Premiums written	9,848	8,862
Commissions paid	1,328	1,056
Claims incurred	426	360
Premiums financed	3,885	3,363

At the end of the year, the amounts due to or from the affiliated companies (note 4) include the transactions referred to above and are payable or receivable in accordance with the relevant agreements, generally on an annual basis.

SCISL provides management and administrative services to the Corporation as well as being the reinsurer (note 6). Administrative expenses charged to the Corporation were $214,000 (2002 - $75,000) and accounts payable are nil (2002 - $1,600).

14. FACILITY ASSOCIATION

The Corporation is a participant in various risk sharing pools whereby most companies in the industry share resources to provide insurance for high risks.

Facility Association transactions recorded in the Corporation's financial results are as follows:

	2003	2002
	(thousands of $)	
Gross premiums written	$ 1,584	$ 1,118
Net premiums written	$ 1,584	$ 1,118
Net premiums earned	$ 1,402	$ 943
Claims incurred	918	872
Commissions	117	181
Premium taxes	48	39
Administrative expenses	182	-
Total claims and expenses	1,265	1,092
Underwriting profit (loss)	137	(149)
Investment earnings	70	-
Net income (loss)	$ 207	$ (149)
Facility Association receivable	$ 2,164	$ 1,091
Unearned premiums	464	258
Provision for unpaid claims	1,430	967

The Insurance Company
Of Prince Edward Island
People you know you can trust